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Appellant,

vs.

WISCONSIN DEPARTMENT OF TAXATION,

Appellee.

On Appeal from the Supreme Court of the State of Wisconsin.

Brief ... Opposing Appellee's Motion to Dismiss or ... Affirm ... Decision of State Court.

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and

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Attorneys for Appellant.

SYNOPSIS.

Synopsis—*Continued.*

Authorities.

Authorities—*Continued.*

In the Supreme Court of the United States

October Term, 1943

No. ....

MINNESOTA MINING & MANUFACTURING COMPANY,

Appellant,

vs.

WISCONSIN DEPARTMENT OF TAXATION,

Appellee.

Brief of Appellant Opposing Appellee's Motion to Dismiss Appeal or Affirm Decision of State Court.

In accordance with Rule 12, Par. 3, and Rule 7, Par. 3, of the Rules of The Supreme Court of the United States appellant files this brief opposing appellee's motion to dismiss or in the alternative to affirm, which was filed with appellee's Statement Opposing Jurisdiction.

The alternative motions of appellee and the statement of appellee opposing jurisdiction are limited to a contention that no substantial federal question exists either on the question of jurisdiction to tax or on the grievance of the appellant with respect to the retroactive application of the tax.

The appellant's Jurisdictional Statement answers most of the arguments asserted by appellee in its Opposing Statement, and this brief so far as possible will be confined to specifically answering certain assertions made by the appellee.

Argument.

POINT I. This case presents substantial federal questions which have not been ruled upon by the court on the jurisdiction of Wisconsin to levy the tax in question.

(a) *In view of the construction given the taxing law by the Supreme Court of Wisconsin, the decision in the J. C. Penney Company case does not apply.*

Appellee argues that the decision of this court in *State of Wisconsin vs. J. C. Penney Co.* (1940), 311 U. S. 435; 61 S. Ct. 246, 85 L. Ed. 267, and companion cases completely preclude there being any substantial federal question in the instant case. We submit that this assertion is without merit.

We pointed out in our Statement as to Jurisdiction that in the *J. C. Penney* case the constitutionality of the law, so far as jurisdiction to tax was concerned, was based

solely on a construction that the law was a supplementary income tax on the corporation and it was held that because the state had given protection to the corporation in the earning of the income it afforded sufficient basis to support the levying of a tax on this corporate income when used in the payment of a dividend. We further pointed out that the whole controversy between the majority and dissenting divisions of this court was predicated on a disagreement between the two divisions as to the nature of the tax and the incidence of the tax;—the majority holding it was a supplemental corporate income tax, the minority holding that it was a transaction tax on the stockholder. No attempt was made in the majority opinion to sustain the law as a transaction tax against the stockholder.

The whole foundation and basis on which the constitutional justification for the tax was predicated has now been entirely removed by the construction given the law by the Wisconsin Supreme Court in a series of cases subsequent to this court's determination in the *Penney* case. That court unequivocally holds the tax to be a transaction tax on the stockholder (as it would seem the statute unequivocally contemplates), and specifically denies that it is an income tax of any kind or nature against the corporation.

> *J. C. Penney Company vs. Tax Commission* (on remand from this court), 238 Wis. 69, 73;
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> *Blied vs. Wisconsin Foundry and Machine Co.*, 243 Wis. 221, 10 N. W. (2d) 142;
>
> *Wisconsin Gas and Electric Company vs. Department of Taxation*, 243 Wis. 216, 10 N. W. (2d) 140.

The opinion of the trial judge, Alvin C. Reis, rendered in the companion case of *International Harvester Co. vs Wisconsin Department of Taxation*, clearly and accurately

reflects the basic difference in what he has asserted to be an "immaculate dilemma" which has been created as the result of the consideration of the *Penney* case by this court as a corporate income tax and the unequivocal determination of the Wisconsin Supreme Court that the tax is a transaction tax on the stockholder. The decision of Judge Reis is an exhibit in the appellant's Statement as to Jurisdiction.

It should also be noted that another most serious constitutional problem arises, if under the present state of the litigation, the result arrived at in the *Penney* case on the jurisdictional question is not changed. If there was justification for Mr. Justice Frankfurter's conclusion in that case that the law was in substance a supplementary income tax it was solely on the ground that the Wisconsin court *at that time* had not determined the incidence of the tax, having merely held that the tax as a transaction tax was unconstitutional. While it appeared quite clearly from the statute and from the consideration that the Wisconsin supreme court had given the statute that the construction given the law by Mr. Justice Frankfurter was incorrect and that the tax that he held it to be was not the tax enacted by the legislature, it would be even more of a fundamental error, if now, in view of the unqualifiedly clear determination of the Wisconsin supreme court, this court should persist in construing the law to mean something other than that determined by the Wisconsin supreme court in order to *sustain* it against constitutional attack.

We can illustrate our observation by consideration of what Mr Justice Frankfurter apparently did in the *J. C. Penney Company* case. In that case the Wisconsin supreme court had seemingly held the tax in question to be an excise tax and to be in violation of the federal constitution. The case then came to this court for the sole purpose of deter-

mining the federal question of whether the Wisconsin court had correctly applied the provisions of the federal constitution to the statute as so construed. Instead of deciding that question this court in effect seemingly overruled the construction so accorded to the statute by the Wisconsin court and held the tax to be an income tax on the corporation, and hence compatible with the Fourteenth Amendment. That is to say, this court overruled the apparent construction accorded to the statute by the state supreme court for the purpose of *sustaining* the statute—not for the purpose of finding that it encroached upon the federal constitution. It should be specifically noted that this court and the Wisconsin supreme court were not differing as to the meaning of the federal constitution—they were differing as to the meaning of a Wisconsin Statute. Did this court have the power to in effect overrule the state court's construction for the purpose of *sustaining* the statute? That was a most important question in the *Penney* case and it becomes increasingly so in view of the present unqualified construction that is now placed upon the law by the Wisconsin court. From the standpoint of the public, from the standpoint of political theory, and from the standpoint of the distribution of power between a state and the United States, this question is of vital importance.

In the *Penney* case this court in its majority opinion apparently *assumed* that it had such power — it did not expressly decide the question of whether it had that power. The decision of that question is far too important to rest upon mere inference. So far as we have been able to determine, after a thorough search, the *J. C. Penney Company* decision was the first decision in the history of the United States Supreme Court that had ever presumed to overrule a state court's construction of a statute for the purpose of sustaining the statute. The usurpation of this

power can have such far-reaching effects that the right to so do should be firmly and unequivocably challenged.

It is of course fundamental that the United States Supreme Court is the guardian of the federal constitution and as such it is the final authority on the meaning of its provisions. Thus the *entire* power to construe the statutes springs from the right and duty of the United States Supreme Court to *prevent* encroachment by any of the states upon the United States constitution.

The reserved power not delegated by the constitution clearly includes the right of a state supreme court to be the final arbiter of the meaning of a statute adopted by the state legislature. In order for the United States Supreme Court to interfere with the powers of the state supreme court to finally construe a statute, it must appear that regardless of the construction adopted by the state, that the thrust of the statute is such as to encroach upon the federal constitution. That fact should be noted carefully, namely, that the right of the United States Supreme Court to overrule the construction placed upon a state statute is only an incident, and can only be exercised as an incident, of the power to prevent encroachment on the federal constitution. *Truax vs. Corrigan,* 257 U. S. 312, 324. In the absence of a finding by the United States Supreme Court, that under what it finds to be the true construction of the statute (as distinguished from the construction adopted by the state court), the statute *invades* the federal constitution, that court must accept the construction placed upon the statute by the state supreme court. Until the decision of this court in the *Penney* case the decisions of this court were consistent with the foregoing. Thus it had been held in a long line of decisions that where a state statute had been construed by the highest tribunal of the state, such construction is regarded as a part of the statute and is as binding upon this court as the text of the statute itself.

The Commercial Bank of Cincinnati vs. Buckingham's Executors, 5 How. 317, 343, 12 L. Ed. 169 (1847);

Hotel and R. E. Int. A. vs. Wis. E. R. Bd., 315 U. S. 437, 440-441 (1942);

Brinkerhoff-Faris Trust and Sav. Co. vs. Hill, 281 U. S. 673, 680, 74 L. Ed. 1107 (1930);

Phoenix Ins. Co. vs. Gardiner, 78 U. S. 204, 206, 20 L. Ed. 112;

Minnesota ex rel Pearson vs. Probate Court, 309 U. S. 270, 273, 84 L. Ed. 744;

Rawlins vs. Georgia, 201 U. S. 638, 639, 50 L. Ed. 899.

The substance of the holdings of the above cited decisions is briefly stated by Mr. Justice Holmes in *Rawlins vs. Georgia,* 201 U. S. 638, 639, 50 L. Ed. 899, 900, where he declared:

> "* * * If the state Constitution and laws as construed by the state court are consistent with the 14th Amendment, we can go no further."

Although not expressly called such, there is a well-established exception to the rule above noted, and that is that the United States Supreme Court has the power to disregard the construction placed upon a statute by the state supreme court when it finds that the true meaning of a statute is such as to encroach upon the federal constitution.

Hanover Fire Ins. Co. vs. Carr, 272 U. S. 494, 509, 71 L. Ed. 372, 380;

Macallen Co. vs. Massachusetts, 279 U. S. 620, 73 L. Ed. 874;

St. Louis Cotton Compress Co. vs. Arkansas, 260 U. S. 347, 67 L. Ed. 297;

Carpenter vs. Shaw, 280 U. S. 363, 74 L. Ed. 478.

In the decision of the *J. C. Penney Company* case, it appears that Mr. Justice Frankfurter either advertently or inadvertently applied the *exception to the rule* in such a way as to completely abrogate *the rule itself.* In that case, the court apparently held that it would determine for itself what the statute means, and then proceed to construe the statute so as to *sustain it*.— not to *prevent* a constitutional encroachment.

It is noted in our Statement on Jurisdiction that if there was any justification for this court construing the statute as it did in the Penney case it was only because *as of that time* the state court may not have clearly determined the incidence of the tax. There can now be no possible justification for such approach, in view of the determination that the state supreme court has now made of the meaning of the law. Accordingly a decision similar to that made by the majority decision of Mr. Justice Frankfurter in the *Penney* case can now only be made by a complete usurpation of the power of the state court to construe its own statute, and in complete disregard of fundamental constitutional law.

That a court is required to accept a tax law as drawn by the legislative body enacting it and is not at liberty to sustain a law by reshaping it to a form where it *might* constitutionally accomplish substantially the same result, is a fundamental rule of law of this court and should not be overlooked or disregarded in the instant case.

This rule was succinctly stated and recognized by Mr. Justice Holmes in *Oklahoma vs. Wells Fargo & Co.*, 222 U. S. 298 at 302, where the learned Justice said:

> "Neither the court below, nor this court can reshape the statute simply because it embraces elements it might have reached if it had been drawn with a different measure and intent."

And the rule is further recognized by Mr. Justice Holmes, with whom Mr. Justice Moody concurred in a dissenting opinion in *Chanler vs. Kelsey,* 205 U. S. 466 at page 482, where it is said:

> "And I also repeat that it has no bearing upon the matter that by a different law the state might have derived an equal revenue from these donees in the form of a tax."

The above rules must be respected in the instant case. This court being bound by the construction of the law as given it by the state court neither has the right to consider its constitutionality as a supplementary corporate income tax nor indeed as any other tax against the corporation, but solely as a transaction tax against the stockholders.

Because the legislature might have enacted a law which would be constitutionally valid (i.e. a supplementary corporate income tax) does not justify this court in sustaining the instant law on the ground that it might have been enacted in a different form under which it would have produced the same amount of revenue.

Under the law as now authoritatively construed, by which this court is clearly bound (i.e. that the law imposes a transaction tax on the stockholder), the dissenting opinion of Mr. Justice Roberts in the *J. C. Penney Company* case is in all respects applicable. In the exercise of intellectual logic it would now seemingly require that this dissenting opinion now be adopted as the decision of this court. Mr. Justice Roberts' dissent, if the law is deemed to impose a transaction tax on the stockholder was not challenged by the majority, nor could it successfully be challenged if the "due process" clause is to have any force or effect whatsoever.

Appellee's counsel also argue that there is nothing inconsistent with the decision of this court in the *Penney*

case and that of the Wisconsin court on remand in the *Penney* case and in the subsequent decisions of the supreme court construing the Wisconsin Privilege Dividend Tax law.

We noted in our Jurisdictional Settlement that the federal courts have found a distinct conflict in the basic construction of the law given by this court in the *Penney* case and the Wisconsin court in the subsequent series of cases.

Judge Duffy, of the Eastern District of Wisconsin, in the case of *Wisconsin Gas and Electric Company vs. United States of America*, 46 F. Supp. 929, a case decided after the decision of the *J. C. Penney Company* case in this court but before the series of decisions in the Wisconsin supreme court, held that because this court had held in the *Penney* case that the tax was a supplementary corporate income tax, the tax was accordingly a tax on the corporation and properly deductible by the corporation for income tax purposes. This decision was appealed to the Circuit Court of Appeals for the 7th Circuit where it was heard *after* the series of recent decisions in the Wisconsin supreme court on the Privilege Dividend Tax law. The Circuit Court of Appeals in *Wisconsin Gas and Electric Co. vs. U. S.*, 138 F. (2d) 597, 598, reversed Judge Duffy because of the recognition of the fact that federal courts are bound by the construction of the law given by the state courts and recognition of the fact that the state court has now construed the incidence of the tax to be upon the stockholder. Judge Minton, who wrote the decision for the Circuit Court of Appeals, specifically recognized that the reasoning of the majority decision in the *Penney* case in effect sustained the conclusion of Judge Duffy that the tax was a tax on the corporation. Judge Minton, in referring to the decision of the *Penney* case by this court, said at page 598:

"The reasoning of that case would seem to sustain the district court's position."

Petition for certiorari to this court was filed on December 30, 1943 for a review of *Wisconsin Gas and Electric Co. vs. U. S.,* and appears as docket No. 565, October 1943 term.

The Tax Court of the United States on the other hand in a recent decision in *Montreal Mining Company vs. Commissioner of Internal Revenue, Respondent* (docket 106876—2 T. C. No. 85, decided September 16, 1943) squarely decided that a corporation had a right to deduct the Wisconsin privilege dividend tax from its gross income for the purpose of determining net income for income tax purposes because it held that this court had determined the tax to be an income tax against the corporation. Thus it quite clearly appears that the federal courts recognized the conflict in the construction of the law existing between the decision of this court in the *Penney* case and the decisions of the Wisconsin supreme court.

As asserted in our Jurisdictional Statement the whole basis on which the law was sustained from a jurisdictional standpoint in the *J. C. Penney* case has now been removed.

(b) *In view of the determination of the Wisconsin Supreme Court that the tax is against the stockholder, the law cannot be jurisdictionally sustained without a complete and unwarranted disregard of the corporate entity and a complete disregard of all decisions of this court.*

As we understand appellee's argument, it is contended that because this court had before it the Wisconsin dividend tax law at the time of its decision in the *J. C. Penney Company* case (even though as of that time the Wisconsin

court had as yet no real occasion to specifically consider the matter), that the *J. C. Penney Company* case must be considered as conclusively foreclosing the contention that the law is unconstitutional as a tax on a stockholder of a foreign corporation. Appellee does not, nor could it, in view of the recent series of Wisconsin decisions, dispute the fact that the tax is a tax against the stockholder.

We challenge the assertion that the majority decision in the *J. C. Penney Company* case can be deemed to sustain the law as a tax against the stockholder. We submit that that decison does not assert any such revolutionary conclusion. A substantial portion of the majority opinion is spent in reaching a conclusion that the tax in substance is nothing more than a supplementary corporate income tax, a conclusion no longer possible in view of the construction given the law by the Wisconsin court. No attempt is made in the majority decision to justify the tax from a constitutional viewpoint as a tax against the stockholder.

Neither does the appellee cite *any* decisions of this court or of other courts (other than the *Penney* case) which it contends sustains the tax as a transaction tax levied on non-resident stockholders of a foreign corporation, where the transaction takes place outside of the state of Wisconsin and the stockholder resides outside of the state imposing the tax, solely because at some time in the past, the corporation may have received the protection of the state in earning certain of the income. Nor could such a result be reached except by complete and utter disregard of the corporate entity and by utterly disregarding all accepted concepts of the corporate entity in business transactions.

The security of business transaction, the regard of the common law for the corporate entity where its existence is used legitimately, should be protected.

This court only recently in an opinion by Mr. Justice Reed in *Moline Properties, Inc. vs. Commissioner of Internal Avenue,* 319 U. S. 436, 438, had occasion to consider the concept of corporate entity and its relation to other phases of the law and particularly to tax law. It was specifically recognized and assumed, as well it necessarily should have been, that the corporate entity where legitimately used has recognized usefulness in business life and should not be disregarded.

To hold that a state has jurisdiction to tax a foreign *stockholder* as such because the *corporation* has enjoyed certain benefits many years before from the state asserting the tax, is a wholly revolutionary concept and the conclusion can be reached only by completely disregarding the corporate entity. The least that could be said of such a conclusion is that it should not be based on mere inference from any language that the court rendered in the *J. C. Penney Company* case. We respectfully submit that the *J. C. Penney Company* case does not reach the conclusion which the appellee contends.

POINT II. **If there is any conceivable basis on which the privilege dividend tax can be sustained jurisdictionally, it is a retroactive tax and a substantial federal question not present in the J. C. PENNEY COMPANY case exists. The Wisconsin Supreme Court was evenly divided on this question.**

Appellee contends that appellant's position that the law is retroactive is inconsistent, in view of its argument that the law is unconstitutonal as a transaction tax on foreign stockholders of foreign corporations

The inconsistency, if such exists, was not initiated by the appellant,—it was initiated by the argument that Wis-

consin has jurisdiction to tax the stockholder of a foreign corporation merely because Wisconsin gave protection to the corporation in earning part of the income used to make up the dividend. There can be no question whatsoever but what the *only* jurisdictional basis upon which the law was sustained by this court in the *J. C. Penney Company* case was that Wisconsin could tax because it had given protection to the earning of income by the corporation. The earning of the corporation obviously took place only in the years in which the income was earned. If the only jurisdictional basis for "charging", so to speak, in the form of a tax, is the earning of the income, it seems almost too clear for argument that Wisconsin by attempting to "charge" for the earning of this income, earned many years prior to the enactment of the privilege dividend tax law, has imposed a prodigously retroactive tax.

This phase of the matter was not before this court in any manner whatsoever in the earlier *J. C. Penney Company* case, because at that stage of the proceedings, the tax had been levied pursuant to a statutory presumption that the dividends were paid out of income earned in the prior year, a presumption that the Wisconsin supreme court on remand held to have been rebutted. The tax was then recomputed as is reflected in the present record, by analyzing the surplus back to the date the corporation first did business in Wisconsin, to determine how much so-called Wisconsin income was in surplus as of December 31st prior to the date of the declaration of the dividend,—and upon declaration and payment of the dividend a tax was assessed against the stockholder on the ratio that such so-called Wisconsin income (regardless of when earned) bore to total surplus.

As pointed out in our Jurisdictional Statement, the decision of the Wisconsin supreme court on the constitutionali-

ty of this asserted retroactive phase of the tax was by an evenly divided court, — three of the Justices being of the opinion that the law was partially unconstitutional and three of the Justices being of the opinion that the law was not unconstitutionally retroactive. We requote from that part of the companion case of *International Harvester Company vs. Department of Taxation*, 243 Wis. 198 at 208, which expresses the view of Mr. Chief Justice Rosenberry and Mr. Justice Martin and Mr. Justice Wickhem who wrote the decision in that case. It is there said:

> "Mr. Chief Justice *Rosenberry*, Mr. Justice *Martin*, and the writer are of the view, (1) that since the United States supreme court has held that the label placed upon this law by the legislature or by this court is wholly ineffective to impair its constitutionality as against the contention that Wisconsin is without power to levy the tax, such label or designation or the selection by Wisconsin of the payment and receipt of the dividend as the occasion for the tax is equally ineffective to save it from objections to its retroactivity; (2) that the earnings of the corporation in Wisconsin upon which are grounded Wisconsin's power to levy the dividend tax must be within reach of a retroactive tax; (3) that the extent of permissible retroactivity should be determined upon the analogy of the income tax cases; (4) that retroactivity should only be permitted to 'recent' transactions; (5) that consistently with these principles the tax may not be applied to earnings in Wisconsin which accrued prior to the last corporate fiscal year preceding the enactment of Wisconsin privilege dividend tax; (6) that by reason of the severability clause, the operation of the tax should be so limited; (7) that nothing in the decision upon remand requires a different conclusion."

Appellee contends that the tax is no more retroactive than a tax on a capital gain in the year of sale of the asset. But no attempt is made under the federal or under the

Wisconsin income tax laws to impose a tax on any part of a capital gain which occurred *before* the enactment of the income tax law. The federal law accepts as the cost price for the determination of whether or not there is a capital gain or loss (as to an asset held at the date of enactment of the law) the fair market value as of March 1, 1913, the effective date of the law. In the instant case, by the use of the formula applied by the respondent, attempt is made to impose a tax for a privilege allegedly granted years before the enactment of the law so taxing it.

Respondent further argues that it is no more a retroactive tax than an income tax imposed upon a stockholder for corporate dividends received by him where the dividend was made up of surplus accumulated from prior years' income of the corporation. This would perhaps be true if the tax was an income tax on the *stockholder,* for the dividend is income to the stockholder in the year that he receives it. But such is not the instant case, — the Wisconsin supreme court on remand in the *J. C. Penney Company* case specifically holding that it was not an income tax, and asserting specifically that as an income tax on foreign stockholders the law would be unconstitutional under the Wisconsin constitution.

> *J. C. Penney Company vs. Tax Commission,* 238 Wis. 69, at 72-73.

We submit that if the tax can jurisdictionally be justified only because Wisconsin gave protection in the earning of the income of the corporation (the only justification asserted by the majority opinion of this court) that inasmuch as in the nature of things such privilege or protection could be given only in the year in which the income was earned, to levy a charge for this protection years after it has been

ranted obviously results in an unconstitutionally retro-
ctive tax.

The conclusion reached by Mr. Chief Justice Rosen-
erry, Mr. Justice Martin and Mr. Justice Wickhem to the
nd that to levy a tax on Wisconsin earnings in surplus for
period beyond that of "recent" transactions renders so
uch of the law as attempts to tax this protection prior to
hat time, unconstitutional, is obviously sound and is the
nly conclusion that honestly can be reached if the "ra-
ionale" of the majority opinion in the *Penney* case on jur-
sdiction to tax is adhered to.

CONCLUSION.

In conclusion we respectfully submit that the record in
his case clearly presents substantial federal questions on
he jurisdiction of Wisconsin to levy any tax, viewing the
w as imposing a transaction tax on the stockholder. We
rther submit that in any event a substantial federal ques-
on is presented on the alleged unconstitutional retroac-
vity phase of the Wisconsin Privilege Dividend Tax law.

Respectfully submitted,

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